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Finance-dominated capitalism in crisis – the case for a Global New Economics Deal

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Hans Böckler
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Fakten für eine faire Arbeitswelt.

1.

Introduction

- Present financial and economic crisis marks a structural break in long-run development
- Neoliberal model of deregulated labour markets, reduction of government intervention and social policies, redistribution of income from (lower) wages to profits and high management salaries, and deregulated financial markets is exhausted
- Main sources of present crisis:

  - inefficient regulation (of financial markets in particular)

  - inequalities in income distribution

  - imbalances (of current accounts) at the global level
- Short-run prevention of a financial melt-down and counter-cyclical policies macroeconomic policies, have to be supplemented by

  - re-regulation of financial markets,

  - re-orientation of macroeconomic policies

  - re-construction of international policy co-ordination and world financial order

2.

Long-run inequalities and imbalances of finance-dominated capitalism and the present crisis

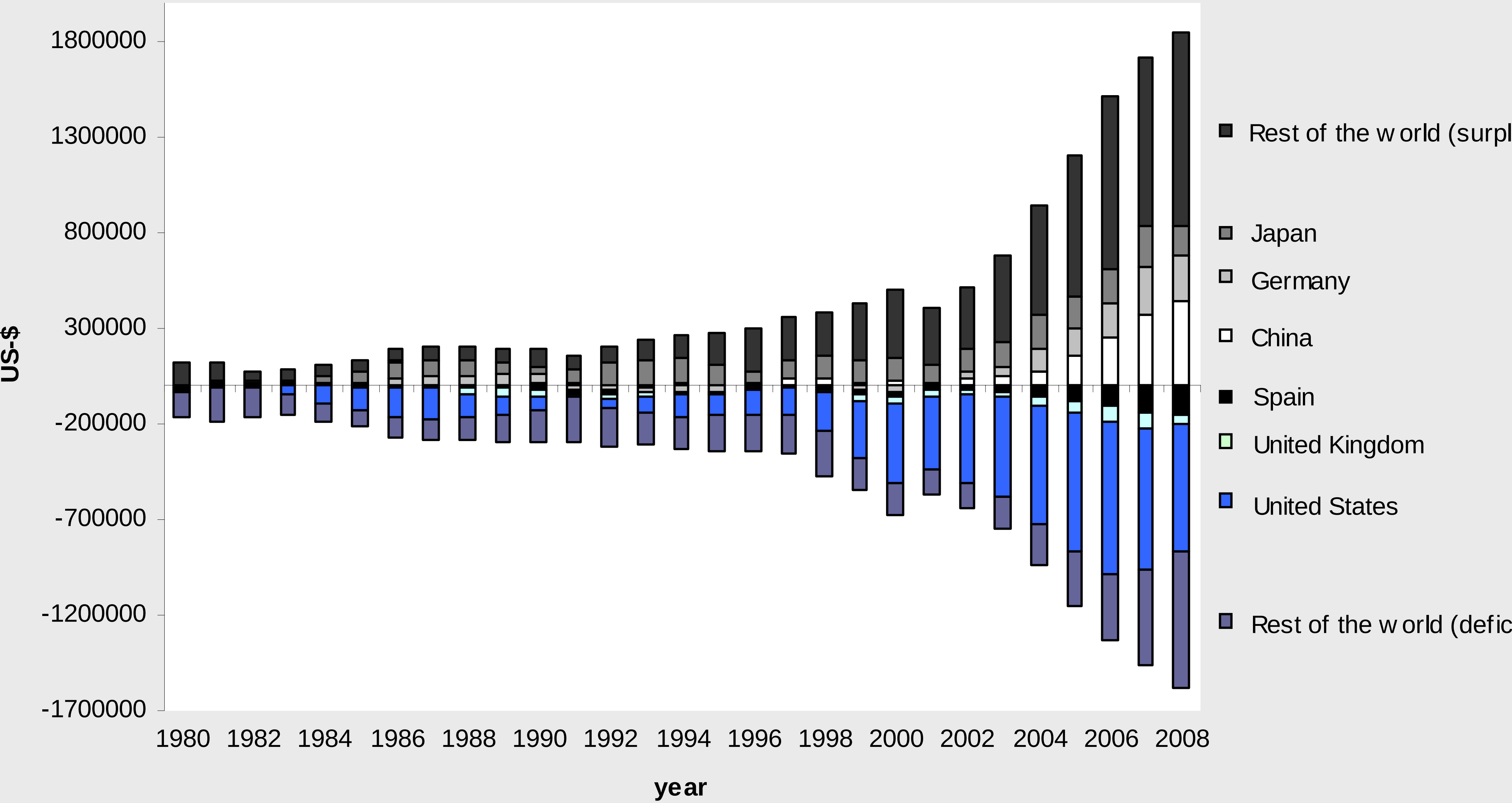
- Current crisis as a consequence of liberalised financial markets, wrong incentives, greed, fraud, naive beliefs, herding behaviour? (Akerlof/Shiller 2009, Baker 2009)

- true, but only part of the story!

- national and global imbalances in the era of ‚financialisation'
  (Bibow 2008, Fitoussi/Stiglitz 2009, Sapir 2009, UNCTAD 2009,
  van Treeck/Hein/Dünhaupt 2007)

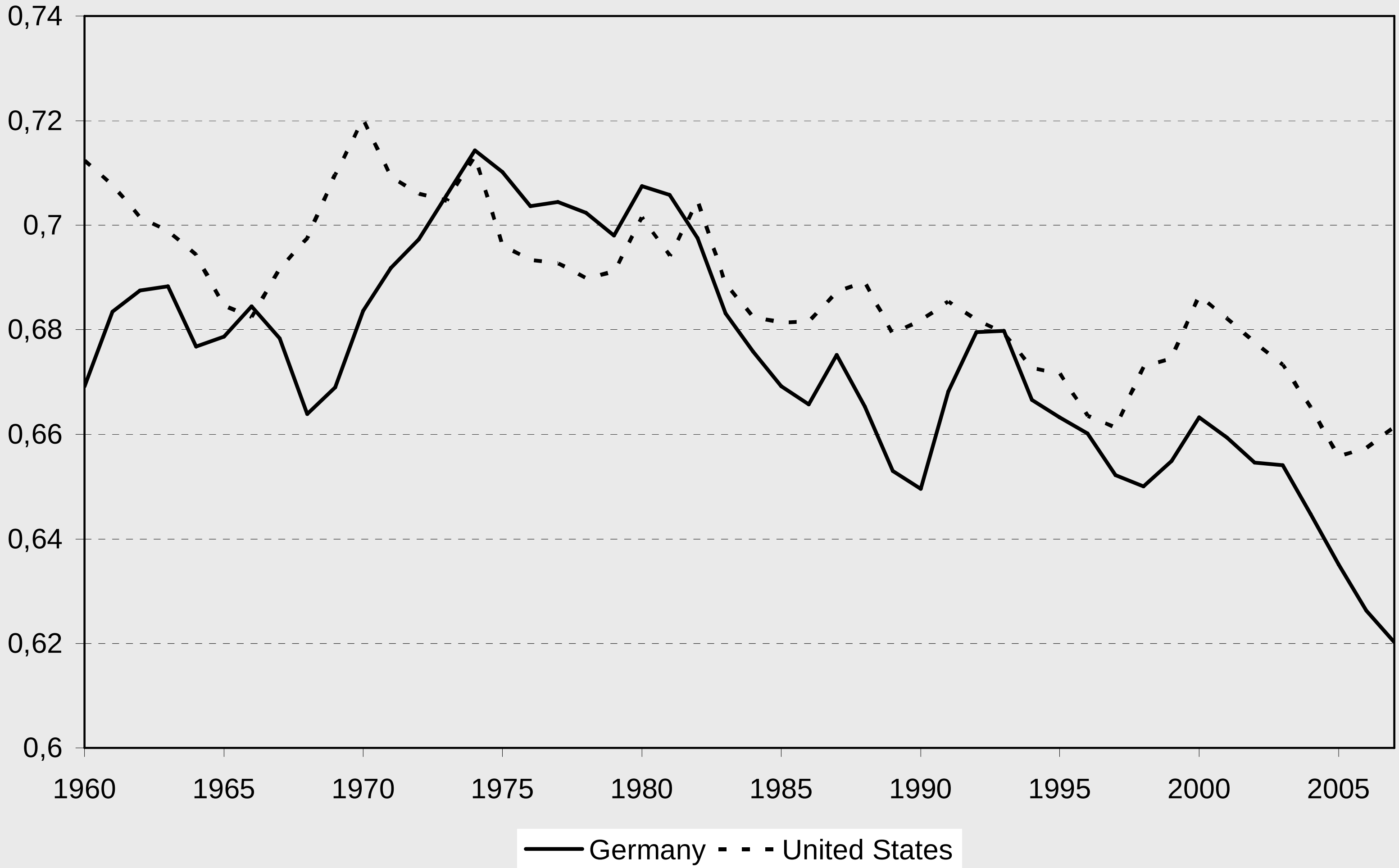
- US and Germany as two main representatives for the macroeconomic imbalances of „financialisation" or „finance-dominated capitalism" (others: UK, Spain, and Japan, China)

Balance on current accounts (1980-2008, 182 countries, in millions of US-$, IMF WEO 2009)



US and Germany as two main representatives of world imbalances …

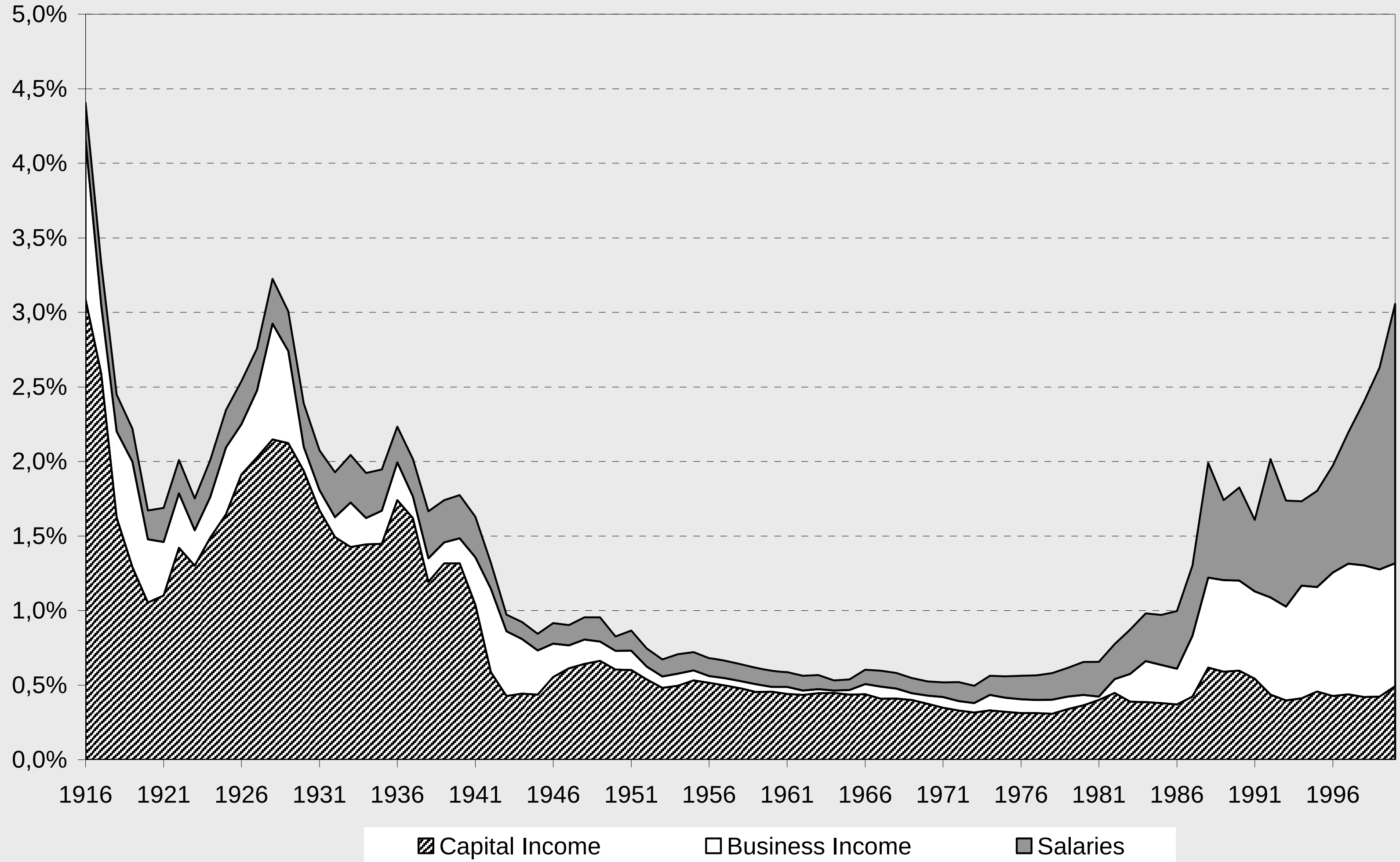
Figure 1: Labour income share in percent of GDP at factor costs in the US and Germany, 1960-2007



Source: AMECO; authors' calculations

Falling tendency of the labour income share since mid 1970s/early 1980s ..

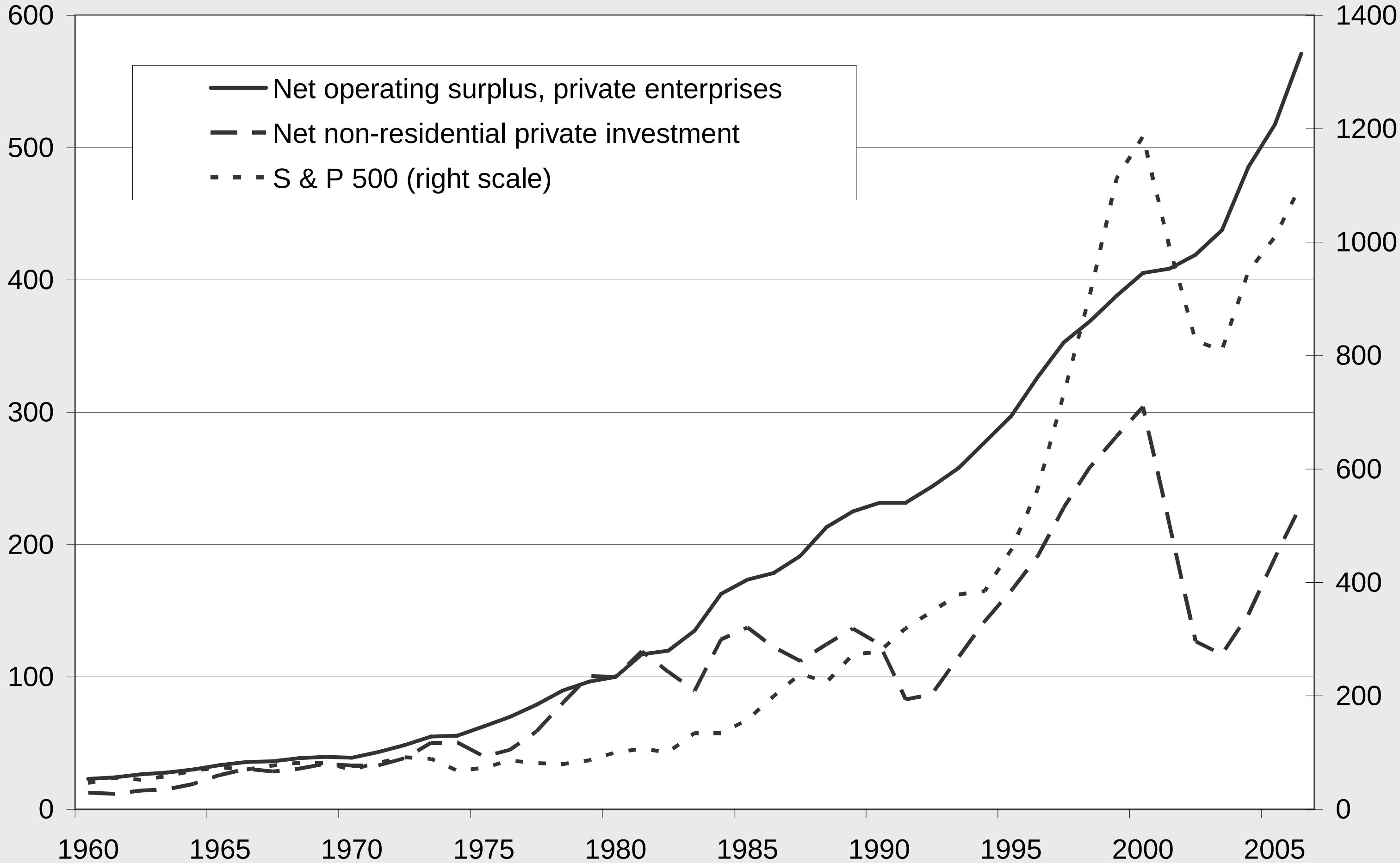
Figure 2: The top-0.01 percent income share and composition in the USA, 1916-2000



Source: Piketty/Saez (2006)

US: inequality in household incomes back to the levels of the 1920s …

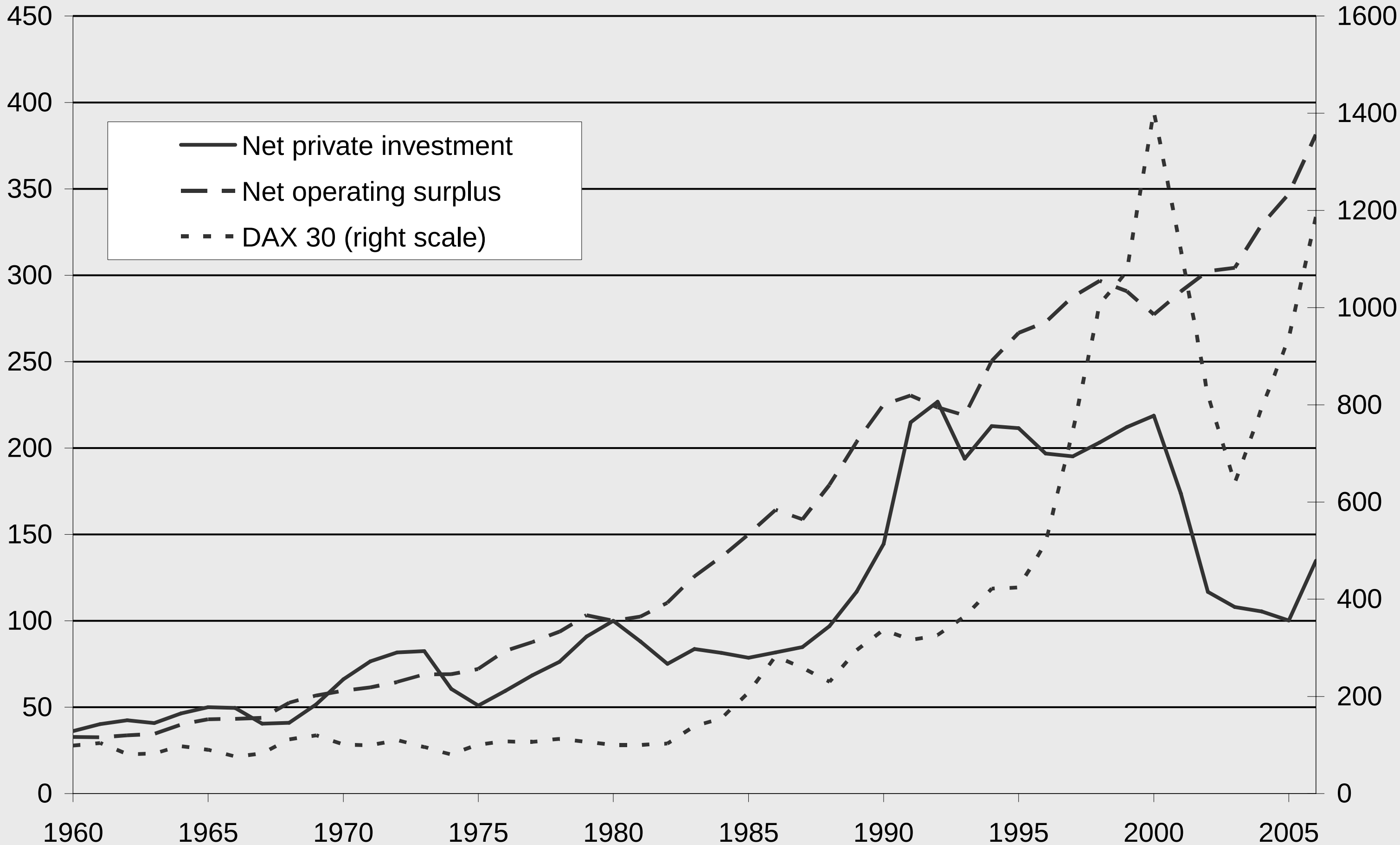
Figure 3: Investment, profits, and share prices, USA, 1960-2006, 1980 = 100



Source: van Treeck (2009), Data are from NIPA, table 1.10; Fixed Assets Tables, table 5.9; author's calculations.

US: profits without investment since the early 1980s, only interrupted by new economy boom

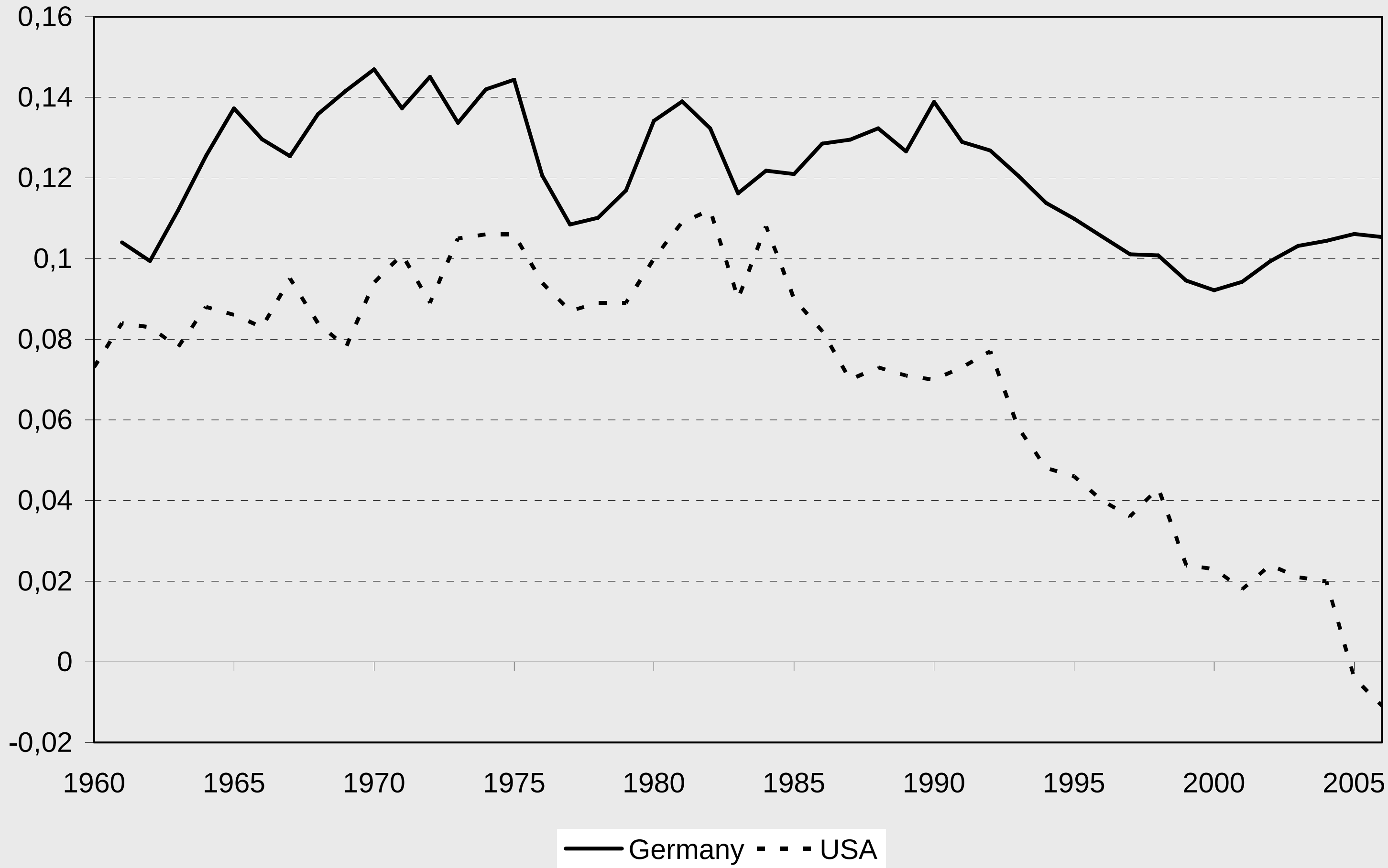
Figure 6: Investment, profits, and share prices, Germany, 1960-2006, 1980 = 100



Source: van Treeck (2009), Data from AMECO; Ecowin; author's calculations.

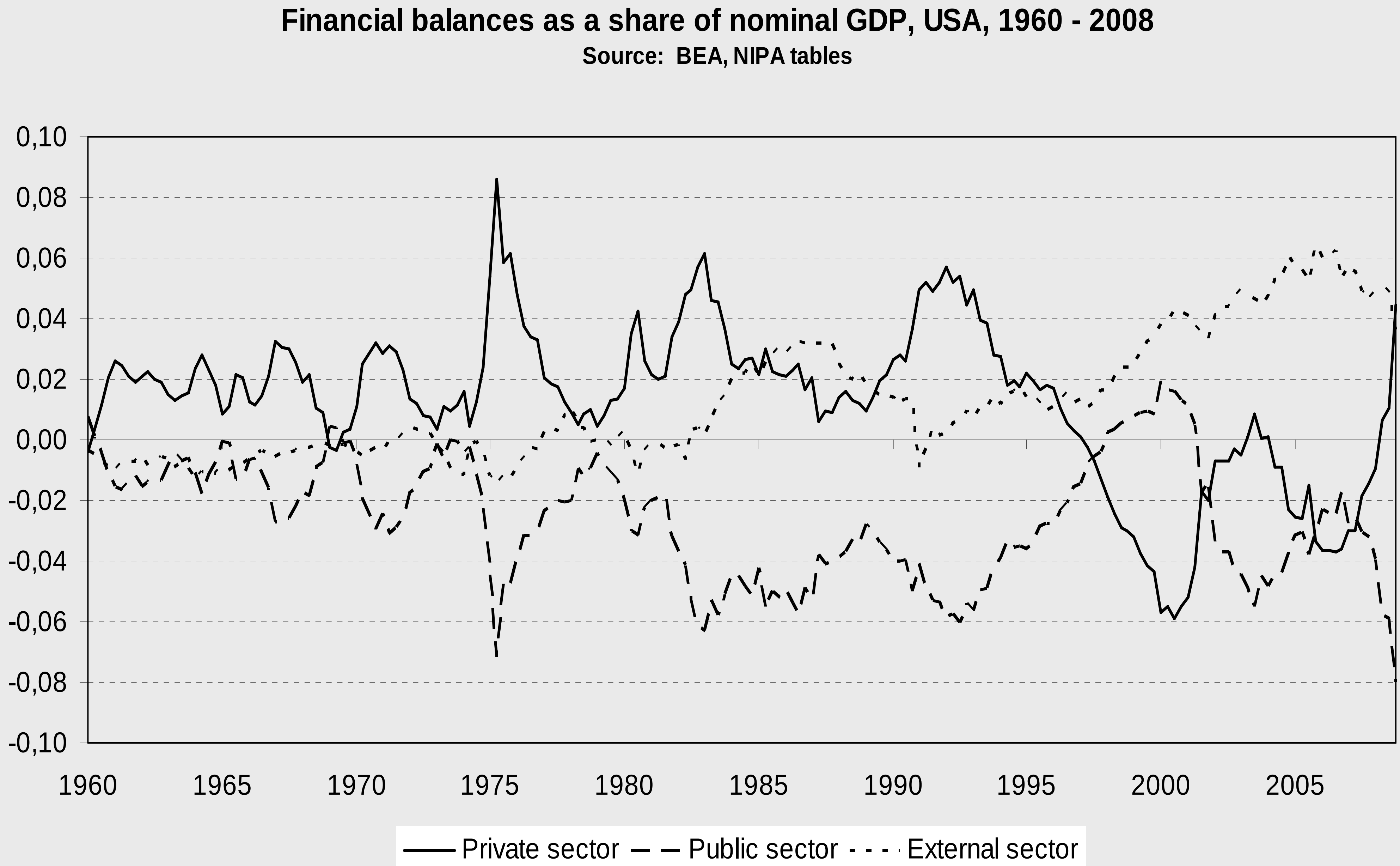
Germany: profits without investment since the early 1980s, only interrupted by unification boom

Figure 4: Saving rate of private households in Germany and the US, 1960-2006

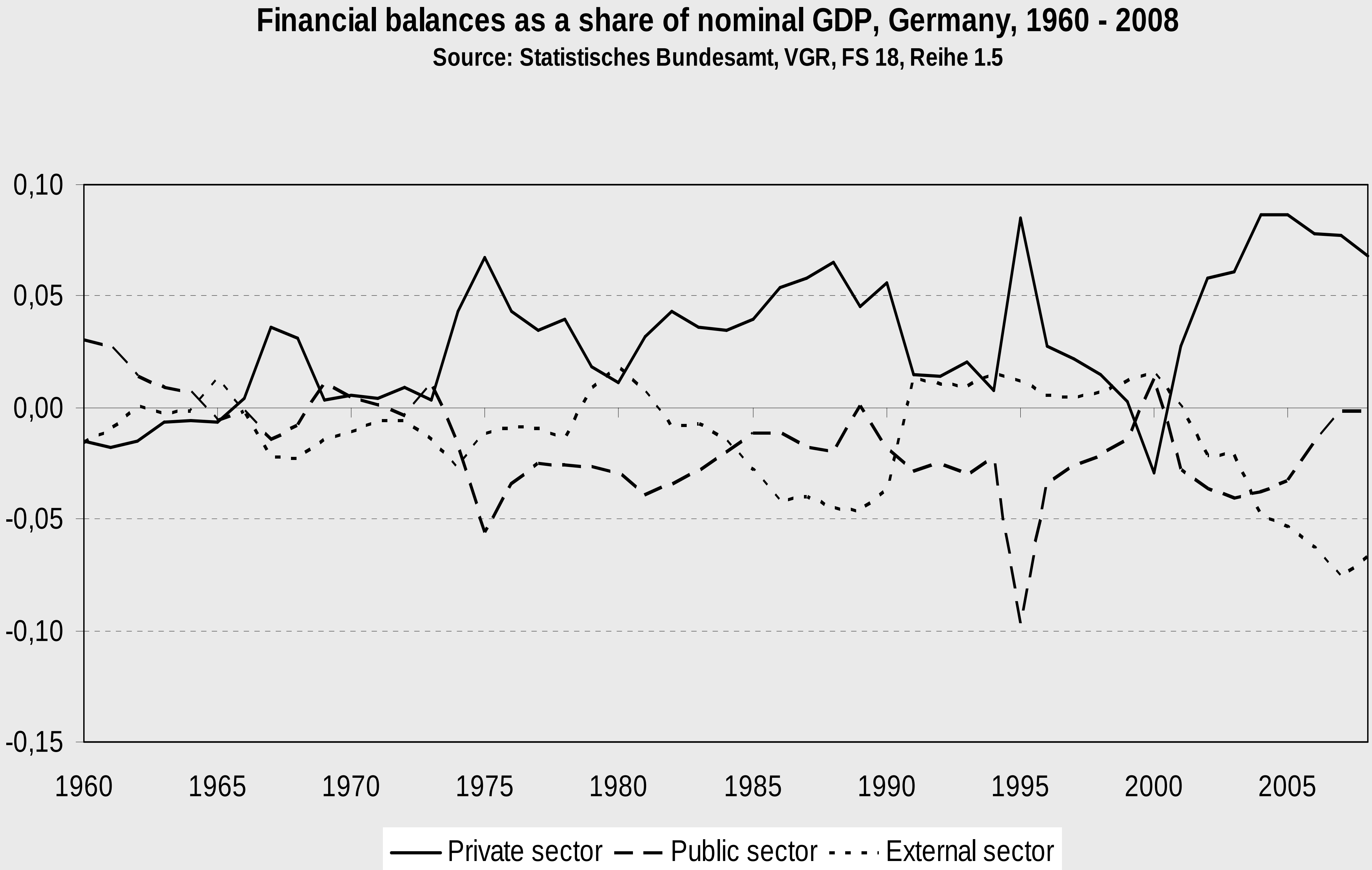


Sources: OECD Economic Outlook No. 80; NIPA; authors' calculations.

Falling saving, rising consumption and household indebtedness against the background of stock market boom and housing price boom solves the demand/profit puzzle in the US – but not in Germany



Unsustainable trends of financial balances and rising fragility in the US since the early 2000s …



Unsustainable trends of financial balances and rising fragility in Germany since the early 2000s …

Financialisation and unstable debt-led private consumption boom in the US

– falling labour income share and increasing inequality in households‘ income

– ‘profits without investment‘ regime (van Treeck/Hein/Dünhaupt 2007)

  ➔ weak private investment (shareholder value orientation, dividend payments and share buybacks) and negative current account (over-valued US$) have been over-compensated by private consumption

  ➔ with stagnating wages, increasing consumption required decreasing propensities to save out of labour and rentiers‘ income

  ➔ increasing household indebtedness (seemingly) backed by collateral generated by asset price and house price bubbles and made possible by financial innovations (credit card debt, securitisation, ‚originate + distribute‘)

– highly fragile constellation, which had to rely on rising property prices and households‘ willingness to go into debt and prevention of sharp depreciation of US$

Dysfunctional mercantilism in Germany - a counterpart to the US development (together with China + Japan)

- falling labour income share, rising inequality in household incomes (Bach/Corneo/Steiner 2007, OECD 2008)

- ‘profits without investment‘ regime
- due to restrictive macroeconomic policies
➔ excessive wage moderation (Hein/Truger 2005, 2007, 2009)

- negative effects of ‚financialisation‘ on investment since mid 1990s
➔ 1991: stock exchange tax abandoned, 1998: legalisation of share buybacks, 2002: capital gains tax for corporations abandoned, 2004: legalisation of hedge funds
- but no positive effects on consumption (no wealth effect)

➔ reliance on the export channel (EX/GDP: 24 percent in 2004, but 47.3 percent in 2008!, current account surplus peaked at 7.9 percent in 2007)

➔ highly fragile, because Germany‘s regime had to rely on growth of the world economy and increasing capital exports, i.e. on the willingness of the rest of the world to go into debt, with the risk of contagion in a financial market crisis

3.

Economic policy reactions in the crisis and perspectives for future development

Immediate reactions
- provision of liquidity to money markets
- central bank as lender of last resort
- bail out of financial sector
➔ successful in the short run, long-run effectiveness and costs still uncertain

Macroeconomic policy reaction?
➔ adequate, given the severeness of the crisis and the structural break in long-run development?
➔ or following the now inadequate role models?

Interest rate policies by central bank:

- Fed: quick cut in interest rates (5.25 percent in 2007 ➔ 0.25 percent in early 2009), introduction of unconventional measures
- ECB: „wait and see“ and „too little, too late“ as usual, increased interest rates in July 2008 (4 ➔ 4.25 percent) because HICP growth increased (oil prices), starts lowering rates in late 2008 (4.25 ➔ 1 percent in 2009)

Fiscal policies

- Massive discretionary reaction in the US:
  6 percent of GDP 2008-2010 (OECD 2009)
- Expansionary fiscal policies in Germany, too, but only 2.5 percent of GDP 2009-2010 (OECD 2009)
- ‚Debt brake' in German constitution ➔ restrictive fiscal policies from 2011 onwards!

Wage policies and unit labour cost growth

- Weak trade unions plus rising unemployment in the US
  ➔ negative nominal unit labour cost growth and deflationary pressure in 2010
- Stable employment in Germany but wage dumping since the late 1990s continues
  ➔ negative unit labour cost growth in Germany and EMU in 2010 ff.
  ➔ as soon as expansionary fiscal policies are terminated risk of deflationary stagnation

➔ Germany (and Euro area) will not contribute to replacing US as world demand engine and tend(s) to follow pre-crisis role model

4.

Requirements for a Global New Economics Deal

1. Re-regulation of the financial (and the real) sector

A. Increase transparency and reduce asymmetric information

- standardisation and supervision of all financial products,
- no off-balance sheet operations,
- national and international regulation and supervision of all financial intermediaries,
- independent public rating agencies instead of private ones,
- strong public and cooperative banks,
- public ownership of financial institutions with systemic importance.

B. Generate incentives for long-run growth

- limits on securitisation to prevent ‘originate and distribute’ strategies,
- reduction or abolition of share buy backs,
- reduction of stock option programmes for managers and minimum holding periods,
- extended co-determination and improved rights of other stakeholders.

C. Contain instability

- equity regulation for all financial intermediaries with counter-cyclical properties (Goodhart 2009),
- asset based reserve requirements for all financial intermediaries (Palley 2003, 2010),
- a general transaction tax for all financial transaction (Schulmeister et al. 2008) and a general capital gains tax.

2. Re-orientation of macroceonomic policies (Hein/Stockhammer 2009, 2010)

A. Monetary policy: low interest rates + supervision and regulation of the financial sector

- abstain from inflation targeting (fine tuning inflation and employment)

➔ asymmetric in short run, counter productive in the long run

- policy of positive but low real interest rates ($i < g$), protection of rentiers‘ wealth, but redistribution in favour of productive sector favours investment
- lender of last resort + regulation and supervision of financial sector

B. Incomes and wage policies: nominal stabilisation + stable income shares

- nominal stabilisation (inflation consistent with balanced current account)
- nominal wage growth = productivity growth + inflation target
- stable wage share

C. Fiscal policy: real stabilisation in the short and the long run + redistribution

- real stabilisation, full employment, more equal distribution
- $G – T = S – I – (X – M)$ at long-run full employment
- redistribution in favour of rentiers is prevented by $i < g$
- stabilise the economy in the face of shocks (automatic stabilisers + discretion)
- public debt stabilises financial markets
- taxation and social policies for income redistribution

3. Re-construction of international macroeconomic policy co-ordination, in particular on the European level, and a new world financial order

A. Reform of European economic policy setting in favour of expansionary macroeconomic policies

- ECB institutional setting + monetary policy strategy (towards Fed)
- replace SGP by coordination along functional finance (expenditure paths)
- re-regulation of labour market, wage bargaining co-ordination, minimum wage legislation
- revive macroeconomic dialogue

B. New world financial order to tackle global imbalances

- fixed, but adjustable exchange rates,
- symmetric adjustment obligations,
- regulated capital flows

➔ UNCTAD (2009): managed exchange rates

➔ Keynes's (1942): International Clearing Union

1. Re-regulation of the financial (and the real) sector

+

2. Re-orientation of macroceonomic policies

+

3. Re-construction of international macroeconomic policy co-ordination, in particular on the European level, and a new world financial order

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Global New Economics Deal

5. Conclusions

- Severe global financial and economic crisis
  ➔ structural break in long-run development
- Although short-run stabilisation seems to be effective ➔ danger of deflationary stagnation, in particular in Europe, in the medium run
- Global New Economics Deal required which addresses the main long-run causes of the crisis: inefficient regulation, inequalitiy and imbalances on the global level
- Politically feasible?

THE END